

UPDATE: PJM Provides Its View

By: David M. Perlman and Jessica H. Miller

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Internal Bilateral Transactions: Regulatory Risk & Confusion Reign

As explained in our alert "Internal Bilateral Transactions: Regulatory Risk & Confusion Reign" dated June 6, 2012, significant regulatory ambiguity exists concerning the regulatory status and compliance criteria for Internal Bilateral Transactions (IBTs), particularly in the PJM Interconnection (PJM). We noted that a clarification of PJM's view as to the scope of tariff-compliant IBTs would be of value to market participants. On June 13, PJM provided such a clarification (PJM Clarification).¹ According to PJM, an IBT can only meet the "physicality" requirement of the tariff in the following ways:

- **either** (a) physical generation (not the market) is contemplated as the ultimate contractual source of the energy that is the subject of the IBT, **or** (b) that a load-serving entity recognized as such under the RAA (not the market) is contemplated as buying the energy that is the subject of the IBT in order to meet that LSE's load serving obligations.
- The ultimate source **and** sink cannot **both** be the spot market. In other words,
 - The ultimate contractual source CANNOT be the market IF the ultimate sink is not a load serving entity with actual physical load (that is, not the spot market).
 - The ultimate contractual sink CANNOT be the spot market IF the ultimate source is not actual physical generation (that is, not the market).
- Intermediate IBTs may be reported if the reporting parties can demonstrate contractually that the ultimate sources and sinks comply with the foregoing.²

Thus, as set forth by PJM, traditional hub transactions (transactions with a hub delivery point that are not contemporaneous sales of generation or consumption by load) are non-compliant. In its Clarification, PJM notes that its tariff interpretation is more expansive than FERC's, because PJM would permit the PJM market to be a source or sink while FERC would not. PJM also advises that market participants should consult counsel and review the *DC Energy Order*³ before eScheduling IBTs.

PJM's Clarification confirms the concerns raised in our June 6 alert that commonplace hub IBTs are now viewed as non-compliant. This is not a prospective finding but, rather, is an

interpretation of an existing tariff provision and will have retroactive implications. As previously noted, FERC has referred DC Energy's past non-compliant IBTs to the Office of Enforcement.

The apparent effect of PJM's Clarification is that traditional hub IBTs with market source and sink cannot be transacted as FERC-jurisdictional forward physical energy contracts scheduled in the RTO. In effect, the purpose of a RTO trading hub—to provide a vehicle to trade such transactions as physical forward contracts—is now apparently largely negated.

These transactions will now need to be conducted as swaps. They will be CFTC-jurisdictional and thus subject to exchange trading and clearing requirements unless eligible for an exemption. Physical electricity market participants will lose a forward contract trading vehicle and be forced to use swaps, which will increase their exposure to CFTC regulation, including potential swap dealing concerns.

We have now heard from PJM. We are awaiting FERC action on the Application for Rehearing of the *DC Energy* Order.

¹The PJM Clarification can be found at www.pjm.com/~media/documents/reports/20120613-pjm-statement-regarding-ibts.ashx

²PJM Clarification at 2.

³*DC Energy v. PJM*, 138 FERC 61,165 (March 9, 2012) (*DC Energy* Order).

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